business partners" and noted the company's "responsiveness, cooperation instead of confrontation, quality of service, and involvement in our community." Id. at 2729. To avoid any situation like Jefferson City arising in the future, TCI has adopted various measures, including implementation of an antitrust compliance program and establishment of specific guidelines for employee behavior.

b. Primestar

Earlier this year, TCI and the other partners in the Primestar Partners, L.P. joint venture to provide medium power ku-band direct to the home broadcast service ("DBS") signed consent agreements with the Department of Justice and with 45 state attorneys general, resolving allegations that the formation and operation of Primestar unlawfully restricted competition. We believed when we began the Primestar venture, and we believe today, that the venture was procompetitive in every way, and our original intention was to contest vigorously any complaint that might be filed. But the long-running investigation was having an adverse effect on the operation of the venture, especially on the decision whether to commit the additional significant investments required to compete in the future. Litigation would have continued those uncertainties for many years. In addition, the passage of the 1992 Cable Act had largely mooted the issues that were the focus of the investigation and had already established in statute most of the relief being sought by the governmental activities. Therefore, while we continue to believe we could have successfully defended any challenge, it just didn't make sense to continue the debilitating uncertainty when the relief sought was largely identical with existing law. With this behind us, we can concentrate on competing with Hughes and Hubbard.

c. QVC - Paramount

Finally, there is the consent agreement signed last month with the FTC requiring that TCI and Liberty divest their ownership interests in QVC (0.8 percent in the case of TCI; 22 percent in the case of Liberty) if QVC is successful in acquiring a 10 percent or greater interest in Paramount Communications. I read with interest the testimony from FTC staff that attempted to explain their position, and I admit to not understanding their thinking any better after that testimony that I did at the time we were negotiating. The FTC witness seemed (to me, at least) unusually willing for a government prosecutor to speculate, without the benefit of facts, about theoretical possibilities that -- if you understood the facts -- just don't exist in the real world.

I understand, Mr. Chairman, that you have praised this decree as preventing some significant competitive harm, but with all due respect, I think you (and the FTC staff) are misinformed. As I have explained earlier in this testimony, the TCI/Liberty interests in programming services are minuscule and raise no serious issues of competitive concern. Certainly, the successful acquisition of Paramount by QVC, which would have resulted in TCI/Liberty having only a 10 percent attributed interest in Paramount, would not have changed this conclusion.

Unfortunately, we didn't have the time to educate the FTC staff on these points, because QVC would, as a practical matter, have been prevented from competing for Paramount merely by the existence of an investigation. Therefore, because our QVC position was a relatively small one, and because QVC was able to find other investors, we decided to just get out of the way and let the Paramount contest continue. I'm glad we were able to do so, or else the recent Delaware Court decision striking down the most egregious features of the sweetheart deal between Mr. Redstone and Mr. Davis would likely have been mooted. I am delighted to see the Paramount board now apparently will allow a fair bidding competition, and I wish Barry Diller and his partners well.

We certainly did not believe that our QVC investment raised any legitimate antitrust issue and we note that the consent agreement was not based on any thorough review by the FTC or its staff of the facts or legal issues associated with the ownership of programming interests by cable operators. Indeed, two of the five FTC Commissioners voted against accepting the decree because they felt that there was no sufficient basis to support any reason to believe that the antitrust laws would have been violated by a QVC acquisition of Paramount.

It is also relevant to point out that the only time that the FTC has addressed the merits of these issues with a full investigation -- in the 1990 proposed acquisition by TCI of a 50 percent ownership interest in Showtime Networks -- it concluded that no competitive concerns existed and approved the acquisition (which was not consummated for unrelated reasons). Of course, in that investigation Viacom argued strenuously (along with TCI) to the FTC that there was no vertical problem. Apparently Mr. Redstone's views depend on the circumstances.

III. CONCLUSION

The next several years will see changes in how we communicate with each other that are hard for most to even grasp conceptually. The Bell Atlantic/TCI merger will be an agent of that change, and we all will be the beneficiaries. Change always creates uncertainties, and uncertainties cause fear in some, but we must not let those fears prevent us from reaching for the opportunity before us.

I hope this testimony has been helpful to the Subcommittee, and I stand ready to answer your questions.

CHART 1

HHI MEASURES OF INDUSTRY CONCENTRATION

Cable Television System Ownership	623[1]
Domestic Theatrical Motion Picture Revenues	1577[2]
Prime Time Television Viewing	1430[3]
Long Distance Carriers' Toll Revenues	3938[4]

[1] Kagan, Cable Television Developments, November 1993.
[2] Variety, January 11, 1993.
[3] Broadcasting & Cable, December 13, 1993.
[4] FCC News, October 5, 1993

CHART 2

TCI/LIBERTY OWNED AND/OR MANAGED CABLE SYSTEMS

TCI/Liberty	**Homes Passed[1] (Millions)**	**Basic Subscribers (Millions)**
Majority Owned	18.8 (20.6%)	10.7 (18.9%)
Majority Owned plus Managed Systems	19.6 (21.4%)	11.2 (19.8%)
TCI/Liberty Total	23.8 (26.0%)	13.4 (23.7%)
National Total	91.4	56.5

[1] All percentages based on estimates of National Total Homes Passed and Basic Subscribers for August 1993, from Paul Kagan Associates, Inc., "Marketing New Media", August 16, 1993, p. 3, as reported in NCTA, Cable Television Developments, November 1993

CHART 3

1992 Cable Subscriber Revenue & Video Rental Revenues

Amounts in Millions of U.S. Dollars

Cable Subscriber Revenues	
Basic Revenues	$13,261
Pay Revenues	$4,930
Total *	$21,694
Video Cassette Rental Revenues	$8,224
Total Basic Cable, Pay Cable, and Video Cassette Rental Revenues	$26,415
All Cable Subscriber Revenues and Video Cassette Rental Revenues	$29,918
TCI Basic Cable and Pay Cable Revenues	$2,945
Total TCI Revenues	$3,574
TCI Basic and Pay Cable Revenues as a Percent of Total Basic Cable, Pay Cable, and Video Cassette Rental Revenue	11%
TCI Total Revenues as a Percent of All Cable Subscriber Revenues and Video Cassette Rental Revenues	12%

* Includes revenues from installation, expanded basic service, pay-per-view, advertising, additional outlets, remote controls, etc.

Sources: NCTA, Cable Television Developments, November 1993.
Video Software Dealers Association.

CHART 4

National Cable Television Video Programming Services

Service	TCI Ownership Interest	Liberty Ownership Interest	Total
American Movie Classics		50.00*	50.00*
America's Disability Channel			0.00
Arts & Entertainment Network			0.00
Black Entertainment Television		17.50	17.50
The Box		11.00	11.00
Bravo			0.00
CNBC			0.00
Cable News Network	24.77		24.77
Canal Sur (Channel South)			0.00
The Cartoon Network	24.77		24.77
Channel America			0.00
Cinemax			0.00
C-SPAN			0.00
C-SPAN II			0.00
Comedy Central			0.00
Country Music Television			0.00
Courtroom Television Network		33.30	33.30
The Discovery Channel	49.29		49.29
The Disney Channel			0.00
E! Entertainment Television	11.02		11.02
Encore		90.00	90.00
ESPN			0.00
EWTN			0.00
Flix			0.00
The Family Channel		15.60	15.60
Fox Net			0.00

* In process of being sold.

Service	TCI Ownership Interest	Liberty Ownership Interest	Total
Galavision			0.00
GEMS Television			0.00
Headline News	24.77		24.77
Home Box Office			0.00
Home Shopping Network	0.96	71.00	71.96
The Idea Channel			0.00
The Inspirational Network			0.00
International Channel			0.00
KTLA			0.00
KTVT			0.00
The Learning Channel	49.29		49.29
Lifetime			0.00
MBC			0.00
Mind Extension University			0.00
MOR Music Television			0.00
The Movie Channel			0.00
MTV			0.00
The Nashville Network			0.00
Nickelodeon			0.00
Nick At Nite			0.00
Nostalgia Television			0.00
Prevue Guide			0.00
Prime SportsChannel Networks		33.90	33.90
QVC Network	0.88**	21.60**	22.48**
The Sci-Fi Channel			0.00
SCOLA/News Of All Nations			0.00

** Subject to divestment under FTC Order.

Service	TCI Ownership Interest	Liberty Ownership Interest	Total
Showtime			0.00
Sneak Prevue			0.00
TBS Superstation	24.77		24.77
Telemundo			0.00
TNT	24.77		24.77
The Travel Channel			0.00
Trinity Broadcasting Network			0.00
TV Asia (new)			0.00
TV-Japan			0.00
Univision			0.00
USA Network			0.00
ValueVision			0.00
VH-1			0.00
VISN/ACTS			0.00
The Weather Channel			0.00
Worship			0.00
WGN			0.00
WPIX			0.00
WSBK			0.00
WWOR			0.00
Z Music			0.00

CHART 5

Twenty Largest
National Cable Television Programming Services

Service	TCI Ownership Interest	Liberty Ownership Interest	Total
ESPN			0.00
CNN (Cable News Network)	24.77		24.77
USA Networks			0.00
TBS	24.77		24.77
Lifetime Television			0.00
The Discovery Channel	49.29		49.29
C-Span (Cable Satellite Public Affairs Network)			0.00
TNN: The Nashville Network			0.00
TNT (Turner Network Television)	24.77		24.77
Nickelodeon			0.00
The Family Channel		15.60	15.60
MTV: Music Channel			0.00
Arts & Entertainment Network			0.00
The Weather Channel			0.00
Headline News	24.77		24.77
CNBC			0.00
VH-1 (Video Hits One)			0.00
QVC Network, Inc.	0.88	21.60	22.48
AMC (American Movie Classics)		50.00	50.00*
WGN			0.00

* In process of being sold.

CHART 6

BIBLIOGRAPHY OF EMPIRICAL STUDIES ON VERTICAL INTEGRATION IN THE CABLE INDUSTRY

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U.S. Department of Commerce, Video Program Distribution and Cable Television: Current Policy Issues and Recommendations, NTIA Report 88-233, June 1988.

CHART 7

Recently Announced Cable Networks

1. Adam & Eve Channel
2. Americana Network
3. America's Talking
4. ATV
5. Booknet
6. Cable Health Club
7. Caribbean Satellite Network
8. The Catalog Channel
9. CNN International
10. Crime Channel
11. Educational & Entertainment Network
12. Encore 2, 3, 4, 5, 6, 7
13. ESPN2
14. FX
15. F.I.T. (Fitness and Exercise Television)
16. Game Channel
17. The Game Show Channel
18. The Gaming Network Channel
19. Global American Network
20. Golden American Network
21. The Golf Channel
22. The History Channel
23. The History Network
24. Home & Garden TV
25. Horizon TV
26. The Idea Channel
27. The Interactive Channel
28. The International Channel
29. Jones Computer Network
30. La Candena Deportiva
31. LMT: Lincoln Mint Television
32. Military Channel
33. MBC Movie Network
34. MOR Music Multiplex
35. National Empowerment TV
36. New Culture Network
37. Network One
38. NewSport
39. Newsword International
40. Northstar
41. Ovation
42. Parasol 4

43. Planet Central TV

44. Q2

45. Recoverynet/The Wellness Channel

46. Romance Classics

47. The Sega Channel

48. Shop at Home

49. Single Information News Network

50. Singlevision

51. STARZ!

52. Style TV

53. Talk Channel

54. Talk TV Network

55. Television Food Network

56. TFN: Telefashion Network

57. TV Macy's

58. Therapy Channel

59. Trax

60. Turner Classic Movies

61. The Western Channel

62. Viva Television Network

63. World African Network

Sources: "New Networks: Still on the Launch Pad," Cableworld at 130-31 (Nov. 29, 1993); "New Networks--A Reader's Guide," Multichannel News at 79-80 (Nov. 29, 1993).

AN ECONOMIC ANALYSIS OF THE FCC'S PROPOSED CABLE OWNERSHIP RESTRICTIONS

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I. Introduction

The Commission's Notice of Proposed Rule Making and Notice of Inquiry on Horizontal and Vertical Ownership Limitations and Anti-trafficking Provisions solicits comment on three basic issues: (1) the nature of the limits to be placed on the number of cable subscribers that can be served by commonly-owned cable systems ("subscriber limits"); (2) the nature of the limits to be placed on the number of channels on a cable system that can be occupied by program services in which the operator has an ownership interest ("channel occupancy limits"); and (3) whether limits should be placed on the ability of cable systems to engage in video program production. The Commission also seeks comments on the implementation of the anti-trafficking provisions of the Cable Act of 1992. This paper provides an economic analysis of each of these issues.

The first section addresses the effect of the existence of large Multiple System Operators (MSOs) on their ability to exercise market power in their dealings with subscribers, advertisers, and cable program services. We begin by describing the efficiencies that result when there are large MSOs. These include efficiencies both in program acquisition and in planning and developing new technologies and services.

Next, we analyze the concerns that larger MSOs might be able to exercise increased market power in dealings with subscribers and local advertisers. We conclude that there is little basis for such concern because commonly-owned cable systems rarely compete as sellers. We also conclude, for the same reasons, that increased concentration in cable system ownership does not raise the risk that cable operators would collude, overtly or tacitly, as sellers.

We next analyze the possibility that multiple system operators serving more subscribers might exercise market power in their dealings with program services. Although this possibility cannot be dismissed as easily as can the threat that market power might be exercised against subscribers and advertisers, we conclude that there is very little risk that the exercise of monopsony power poses a threat to the diversity and quantity of programming available to consumers. The nature of bargaining between large MSOs and cable program services permits prices to be raised for some services without increasing the prices that are paid for others. As a result, even if large MSOs can affect the prices they pay for programming, they will have no incentives to restrict their purchases of cable program services. For all these reasons, we favor relatively high limits on the number of cable subscribers that can be served by commonly-owned cable systems. We conclude that neither the current level of horizontal concentration in cable ownership, nor an increase in that concentration, pose a substantial threat of increased market power and reduced program diversity.

Our analysis of the issues involving vertical integration, which are raised by the channel occupancy limits, is more complex.

We begin our analysis by describing the efficiencies that may flow from vertical integration between cable systems and cable program services. These efficiencies clearly must be balanced against any anticompetitive concerns.

We cannot dismiss, as theoretical matter, the possibility that a cable program service that is vertically integrated with a cable operator might be able to use that relationship to disadvantage a rival service. In the context of the cable television industry, however, the set of factual circumstances in which such behavior would be profitable are sufficiently stringent that we cannot regard this as an imminent threat. This is so for several reasons. The cable operator may be unable to damage the rival service because the operator is too small, because the rival service is profitable enough to withstand the loss of revenue, or because the rival service can protect itself by lowering payments to programming inputs. Foreclosure, even if it could harm the rival service, may yield little or no payoff because the affiliated program service faces too many other substitutes. The costs incurred by the cable operator incurred to disadvantage the rival service may be greater than the gains of the affiliated program service. The ownership of many program services is dispersed, raising the prospect that the foreclosing cable operator must share the gains with other owners of the service who do not bear the associated costs. Finally, rival program services may have means of protecting themselves from harm -- what economists call counterstrategies -- that prevent a foreclosure strategy from succeeding. As a result of the efficiencies generated by vertical integration and the difficulties of engaging in foreclosure, we favor relatively high channel occupancy limits.

Our analysis of whether cable operators should be allowed to engage in program production concludes there is no need for setting limits on such behavior. The principal involvement of cable operators in program production has been somewhat indirect, either the consequence of an ownership interest in program services, or because an entity with ownership interests in program production also has ownership interests in cable systems.

We would not expect to see large scale involvement of program services in program production. There are, however, circumstances in which efficiencies in program production are achieved less easily by contract than by vertical integration. We see few risks that anticompetitive behavior would be fostered in such circumstances if cable systems were to take part in program production. Preventing the involvement of cable systems in program production, particularly when it is often indirect, is likely to prevent the achievement of efficiencies while offering few, if any, offsetting advantages.

Finally, we present several reasons why the Commission should implement the anti-trafficking provisions of the 1992 Cable Act in a liberal manner. We recommend that the Commission minimize the extent to which these rules block transfers of ownership because transfers typically will promote the efficient operation of cable systems without posing a threat that they will lead to higher prices being charged to consumers.

II. Ownership Limits

Section 11 of the new Cable Act requires the Commission to promulgate limits on the number of households any single owner of cable systems can reach. The existence of firms with large shares of a well-defined market, often raises concerns about the exercise of market power. In this section, we analyze whether similar concerns are present in the case of the ownership of cable television systems and whether, therefore, stringent limits should be placed on the number of subscribers (or homes passed) that can be served nationally, or regionally, by cable systems that are under common ownership.[1]

There are four types of transactions in which large MSOs engage that might potentially raise concerns about anticompetitive behavior. First, there are transactions in which cable systems sell their basic, enhanced, and premium services to subscribers. Second, there are transactions in which cable systems sell advertising time in spots that are made available to them by the

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[1]Our discussion throughout focuses on the number of subscribers served by any cable system because that is one of the key characteristics affecting the kind of behavior described in the text. However, any ownership limit should be based on the number of homes passed rather than the number of subscribers; otherwise, multiple system operators that are approaching a subscriber limit would have incentives to artificially depress the number of subscribers. Because virtually all local franchise authorities require the wiring of the entire franchise area, comparable disincentives would not arise with a limit on homes passed.

national program services. Third, there are transactions in which cable systems acquire the services that they offer to subscribers from the packagers or producers of those services. Finally, there are the transactions in which cable systems hire the labor that performs the technical and administrative functions that they require in order to operate. The first two of these fall under the heading of potential market power as sellers, and are considered together below. We also address the third issue, the potential for cable MSOs to exercise market power as buyers. The final set of transactions clearly raises no issues of anticompetitive behavior and we do not consider it further.

A. Efficiencies from Multiple System Operation

To give some perspective to our analysis, it is important to recognize that size, *per se*, is no cause for competitive concerns. Firms may choose to grow to a particular size because that permits them to achieve efficiencies that are not available if they operate at a smaller scale. Moreover, firms that are successful because they operate at lower costs or are better able to meet the demands of consumers, frequently grow to a large size. Penalizing such growth and development risks promoting inefficiency by reducing the incentives and opportunity for efficient growth.[2]

[2] Of course, relatively large firms that earned dominant status through efficiencies may engage in anticompetitive strategies to maintain a dominant position. An efficient remedy would be one that is targeted to the firm-specific anticompetitive practices. By contrast, a prophylactic ban on growth would sacrifice the efficiencies that drive that growth.

As the Commission acknowledges in its Notice, significant efficiencies may result when cable systems in different geographic markets are under common ownership. These efficiencies take two basic forms, reduced costs of program acquisition and reduced costs of administration and planning for new technologies, services, or both.

In a previous paper that we submitted in the Commission's program access proceeding, we explained at some length how the costs incurred by a program service can be reduced significantly if it can deal with a single entity that negotiates on behalf of a large number of separate cable systems instead of dealing separately with each system.[3] First, there are savings in contracting costs that result when the service can negotiate with a single purchaser rather than having to reach an agreement with a large number of separate buyers. Second, and perhaps more important, there are lower costs of marketing when a single decision-maker can commit to taking a service for a large number of separate cable systems instead of the service having to obtain commitments from many separate operators. Competition among program services for the right to serve the subscribers of large MSOs results in these cost savings being passed on in the form of

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[3] S.M. Besen, S.R. Brenner, and J.R. Woodbury, "Exclusivity and Differential Pricing for Cable Program Services," attached to Comments of Tele-Communications, Inc., before the Federal Communications Commission, In the Matter of Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992: Development of Competition and Diversity in Video Programming Distribution and Carriage MM Docket No 92-265 (January 25, 1993).

lower wholesale prices. This, in turn, may result in lower subscriber rates.

Economies of scale also exist in administration and planning for new technologies and services. Many of the costs of these activities are independent of the number of subscribers being served. Because smaller MSOs will have higher costs per subscriber, they are likely to invest less in planning for new technologies and services.

With regard to innovation, large MSOs have historically played a large role in developing new services, encouraging the introduction of services developed by others, and in supporting existing services through periods of financial difficulty. This behavior is consistent with a growing body of evidence that shows that many important advances originate with users rather than suppliers, or involve a substantial contribution by users.[4]

Because many improvements will not be subject to protection under the intellectual property laws, unless users are large enough to appropriate a significant share of the benefits of these advances they will not undertake the necessary innovative activity.[5] Indeed, smaller MSOs are more likely to wait for others to start a "bandwagon" for a new program service or technology. Therefore, one would expect that innovative activity

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[4]For an excellent study of innovative activity that emphasizes the role of users, see E. von Hippel, The Sources of Innovation, New York: Oxford University Press, 1988.

[5]For service innovations in the cable industry, trade secret protection would also be unavailable.

in the cable industry would be adversely affected if significant limits were placed on cable system ownership.[6]

B. MSOs and the Prices Paid by Subscribers and Advertisers

Measures of ownership concentration have a different meaning for cable television systems than they do for firms in other industries for one very important reason. With very rare exceptions, cable systems serve discrete geographic areas, i.e., they do not compete directly with one another either for subscribers or for local advertising revenues. As a result, one cable system's market power in selling to either advertisers or viewers within any given geographic market is unlikely to be enhanced if the system acquires, or is acquired by, another system serving a different geographic area. Nor for these transactions is the potential for collusive behavior in the industry increased when concentration increases, because cable systems are not direct competitors.

There are two possible exceptions worth noting. First, in theory, a given cable system may encounter a competitive threat from those systems on the edges of its geographic area. However, because there have been so few instances of overbuild competition

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[6] Clearly, some advances in technology and services will originate with firms that supply the cable industry. However, even in these cases, there will some need for suppliers to coordinate with cable systems and only large MSOs are likely to take on this role. For two recent examples see P. Lambert, "TCI: $200 Million for Channel Explosion," Broadcasting, December 7, 1992, p. 5 and H.A. Jessell, "Time Warner Connects to Long Distance," Broadcasting, December 7, 1992, p. 19.

since cable's infancy, this threat is not likely to warrant a limit on national ownership concentration.

Second, there may be interdependent cable advertising demands across geographically proximate areas. One obvious problem with such a characterization is the implicit assumption that cable advertising is a relevant antitrust market. In fact, it is likely that in most, if not all, cases, the smallest antitrust market consists of the advertising of at least all local broadcast stations. This is certainly suggested by the NAB's reasons for seeking a new must-carry rule before the FCC and Congress: broadcast stations and cable systems compete for many of the same advertisers, and the NAB fears that cable operators will not carry them on their systems. In correctly-defined local advertising markets, the share of cable operators in total advertising revenues is quite small.

Even if the merger of geographically proximate systems posed an anticompetitive threat, however, a national limit on the number of subscribers reached will not (except by chance) target what is likely to be a highly localized problem. Arbitrarily defined regional limits on subscribers -- for example, state-wide limits on subscribership -- are no more relevant than national limits. The appropriate geographic scope of such limits would have to be imposed on a costly case-by-case basis.